Filed 7/20/09 Housing Authority of the City of Los Angeles v. KPMG LLP CA2/1

NOT TO BE PUBLISHED IN THE OFFICIAL REPORTS

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION ONE

HOUSING AUTHORITY OF THE CITY OF LOS ANGELES, Plaintiff and Appellant, v. KPMG LLP, Defendant and Respondent.	B207313 (Los Angeles County Super. Ct. No. BC364725)

APPEAL from a judgment of the Superior Court of Los Angeles County, William F. Fahey, Judge. Affirmed.

Meyers, Nave, Riback, Silver & Wilson, Joseph M. Quinn, Geoffrey Spellberg and Moira K. O'Neill for Plaintiff and Appellant.

Sidley Austin, Michael C. Kelley, James M. Harris, Bradley H. Ellis and T. John Fitzgibbons for Defendant and Respondent.

Appellant Housing Authority of the City of Los Angeles (HACLA or Housing Authority) appeals from the trial court's judgment in favor of respondent KPMG LLP (KPMG) following KPMG's motion for summary judgment and from the trial court's order requiring HACLA to pay KPMG's expenses of proving facts that HACLA denied in response to requests for admissions. As to claims HACLA has labeled as claims for breach of contract and breach of the implied covenant of good faith and fair dealing, HACLA contends the trial court erred in applying the two-year statute of limitations set forth in Code of Civil Procedure, section 339, subdivision 1,[1] which applies to claims for professional negligence. In addition, it argues these claims are timely under the four-year statute of limitations set forth in section 337, subdivision 1 applicable to contract claims because the four-year period did not commence to run due to HACLA's lack of notice of its potential claims. As to its professional negligence claim, HACLA contends that the claim is not barred by the two-year statute of limitations because the claim did not accrue more than two years before the complaint was filed. In addition, HACLA contends the trial court erred in finding that there was no triable issue of fact as to whether HACLA could prove causation. Finally, HACLA contends that the trial court erred in granting KPMG's motion for costs of proof and abused its discretion in awarding an excessive amount of fees and costs for that proof.

As we conclude the action is barred by the two-year statute of limitations set forth in section 339, subdivision 1, we do not address HACLA's claim of error with respect to the trial court's determination that there was no triable issue of fact as to whether HACLA could prove causation. We further conclude the trial court neither erred nor abused its discretion in awarding KPMG its costs of proof. Accordingly, we affirm.

---

[1] Unless otherwise indicated, all statutory section references are to the California Code of Civil Procedure.

BACKGROUND

The facts set forth below are drawn from KPMG's Reply Separate Statement of and its First Amended Complaint (FAC) and are admitted unless otherwise indicated.

The parties and the terms of the engagement

HACLA is a state chartered public housing agency that provides affordable housing in the City of Los Angeles. HACLA is governed by a seven-member Board of Commissioners (BOC) appointed by the mayor of Los Angeles.

From 1994 until the United States Department of Housing and Urban Development (HUD) required his resignation in March 2004, Don Smith (Smith) was HACLA's executive director. Lucille Loyce (Loyce) served as HACLA's assistant executive director from December 1999 until she was fired on April 29, 2004. From 1996 until 2004, Dwayne Williams (Williams) was paid as a consultant by HACLA and its Resident Management Corporations/Resident Advisory Councils (RMC's).

Beginning in 1994, HACLA engaged defendant and respondent KPMG to audit HACLA's financial statements in accordance with generally accepted government auditing standards. KPMG explained its auditing standards to HACLA, including any obligation to discover and report fraud, in its engagement letter, attached as exhibit A to the FAC:

"We will conduct the audit of the financial statements with generally accepted auditing standards and the standards for financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The objective of an audit carried out in accordance with such standards is the expression of an opinion as to whether the presentation of the financial statements, taken as a whole, conforms with generally accepted accounting principles." [¶] . . . [¶]

"An audit is planned and performed to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Absolute assurance is not attainable because of the nature of audit evidence and the characteristics of fraud. Therefore, there is a risk of material errors, fraud (including

fraud that may be an illegal act) and other illegal acts may exist and not be detected by an audit performed in accordance with generally accepted auditing standards. . . .

"To the extent that they come to our attention, we will inform management about any material errors and any instances of fraud or illegal acts. Further, to the extent that they come to our attention, we will inform the audit committee about fraud and illegal acts that involve senior management, fraud that in our judgment causes a material misstatement of the financial statements of HACLA, and illegal acts, unless clearly inconsequential, that have not otherwise been communicated to the audit committee."

"In planning and performing our audit, we will consider HACLA's internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements; not to provide assurance on HACLA's internal control. . . . The limited purpose of this consideration may not meet the needs of some users who require additional information about internal control. We can provide other services to provide you with additional information on internal control which we would be happy to discuss with you at your convenience."

With respect to the provisions of OMB Circular A-133 that applied to the audit, KPMG stated: "The tests of internal control performed in accordance with OMB Circular A-133 are less in scope than would be necessary to render an opinion on internal control."

Events placing HACLA on notice of possible wrongdoing by Loyce, Williams, Smith and other employees

In May of 1997, HACLA employee Margaret Gardenhire (Gardenhire) gave the BOC documents alleging that Williams had asked Gardenhire to "'cause delays on the moving jobs'" so that the moving jobs would incur extra charges. Gardenhire further alleged that when she informed Loyce, Loyce told her to throw away the evidence against Williams and not to let Smith see it. Gardenhire also expressed concern that Loyce retaliated against her for reporting Williams's activities.

On November 21, 1997, Gardenhire filed a whistleblower/retaliation complaint in the action entitled *Gardenhire v. Housing Authority of the City of Los Angeles*, alleging that "Gardenhire had alerted Loyce to 'fraud, waste and dishonesty in the way Williams was operating,' and that Loyce was aware of Williams's fraud, stealing of public funds, and other illegal activities."

On January 5, 1998, Commissioner Diane Middleton resigned from the BOC and stated in her resignation letter sent to fellow BOC members and others that she was concerned about:

- "misuse of taxpayer funds";
- HACLA employee whistleblower lawsuits;
- Her belief that HACLA deliberately kept information from her; and
- Her feeling that "HUD should conduct an independent audit on federal funds."

On March 30, 1999, a jury awarded Gardenhire $1,425,000 in damages against HACLA. The BOC met in closed session on May 27, 1999 to discuss the *Gardenhire* litigation.

The award was later affirmed by Division Four of this Court in a published decision, *Gardenhire v. Housing Authority* (2000) 85 Cal.App.4th 236. The court found the essential facts not greatly disputed. Notably, Gardenhire told Loyce in September 1996 that Williams, who had a contract with one of the RMC's to move residents who were being temporarily relocated, had encouraged Gardenhire to delay resident moves so that Williams would get paid more. In addition, Loyce asked Gardenhire to give Williams copies of bids from other companies, and another HACLA employee retyped a bid Williams had submitted so that it was lower than other bids on that project.

On May 9, 2000, Sucretta Small sent a letter to BOC Chair Ozie Gonzaque warning that "[t]here was a kick-back situation going on" involving Williams at another one of the Housing Authority's housing developments.

On October 2, 2000, a class action complaint was filed in Los Angeles County Superior Court against HACLA entitled *Ochoa v. Housing Authority of the City of Los*

Angeles, Case No. BC237783 (the *Ochoa* complaint). The *Ochoa* complaint alleged, among other things, that:

• "'Loyce and Williams are old hometown "friends" . . . and they apparently perfected their modus operandi while Loyce was serving as a director of Milwaukee Housing Authority';

• "'Loyce imposed Williams upon the RMCs "as a $100 per hour 'consultant,' to be paid out of noncompetitive section 3 Public Housing Grants, funded 100%" from HUD;

• "'Williams then began to set up companies for profit, as separate entities from the RMC. He set up a moving company, a detrashing company, a security company and plumbing companies—all for profit . . . all with the knowledge and approval of HACLA';

• "'Loyce engaged in Fraudulent Transfers and Fraudulent withdrawal of the resident's funds. She sat (sic) up an account in the name of Jordan Downs Resident Group, Inc., deposited funds therein and wrote checks to Williams';

• "'Williams has knowingly "double-billed," "double-invoiced" for his services.'"

On November 16, 2001, investigators from HUD's Office of the Inspector General (OIG) met with Smith, Loyce and HACLA Director of Planning and Economic Development Ed Griffin "'to discuss the scope of HUD-OIG's review'" which was prompted by complaints about Williams and Loyce. OIG's on-site field work at HACLA began in November of 2001 and continued until October 31, 2002.

On February 13, 2002, the *LA Weekly* reported that OIG was auditing HACLA "because residents allege job-training programs are rife with fraud and mismanagement of funds." The article also reported that a recent lawsuit filed by residents alleged "that assistant director Lucille Loyce improperly gave contracts to consultant Dwayne Williams . . . [who] double-billed and used phony contractors." The author reported that Williams had been a consultant at nine public housing projects. The article continued: "Congresswoman Juanita Millender-McDonald also raised concerns about possible

misspending in a letter to the commission in November 1997. Housing Authority Director Don Smith insists that expenditures are closely monitored."

On February 21, 2002, the *Los Angeles Times* reported that HUD had begun an audit of HACLA because of "[p]ersistent allegations of financial wrongdoing at public housing projects. . . . [¶] At issue, city officials said, is whether the agency or others misspent some of the $25 million in federal funds funneled to residents for providing security, janitorial and moving services at the 20 city-run housing developments." The audit would focus on allegations that HACLA managers "manipulated bids on contracts, tolerated double-billing by a well-connected consultant and retaliated against those who got in the way." The article further stated that "[a]t the center of the controversy is private consultant Dwayne Williams, who has received $125-an-hour contracts to help resident groups organize security, moving and janitorial services at six city housing projects." It was estimated "that Williams has been paid more than $1.2 million since 1995 by the agency and resident groups." An attorney for the Housing Authority "credited Loyce and Williams with bringing millions of dollars to job-creation programs in Jordan Downs and other housing projects."

On November 20, 2002, OIG sent HACLA's then-executive director Smith a letter outlining OIG's various outstanding requests for information and documents from HACLA. OIG outlined specific requests for documents pertaining to numerous HACLA contracts involving Williams, including at least nine such contracts that would ultimately be discussed in OIG's Audit Report Number 2005-LA-1805.[2] Requesting "[i]dentification of the entity/individual who actually performed the moving services (and the actual cost) relating to Purchase Orders 061505, 063566, 060317, and 060980 issued by HACLA to D.E. Williams & Associates in 2000 and 2001," OIG further sought an "[e]xplanation as to why a consultant would be paid to perform moving services."

---

[2] HACLA only denied KPMG's "characterization as to HACLA's involvement in these contracts." As there was no such "characterization," this fact is not disputed.

On March 30, 2004, HUD's OIG issued Audit Report Number 2004-LA-1002, stating that "OIG's investigation was prompted by complaints of kickbacks and unfair bidding, and finding that HACLA improperly entered into a $1.8 million litigation settlement without HUD approval and incurred $119,440 in ineligible attorney fees 'on behalf of a consultant.' Remaining findings from the investigation were withheld at that time pending a possible criminal prosecution."

In March of 2004, HUD required HACLA to replace Smith. The Board appointed Judy Luther (Luther) to serve as the acting executive director.

On March 30, 2004, BOC Chair Elenore Williams (E. Williams), BOC member David Rubin, assistant city attorney Craig Takenaka (Takenaka), Loyce, and Luther met with HUD representatives to discuss HUD's desire to "take the Housing Authority over" because of "misappropriation of funds" and the improprieties of Smith and Loyce.

In early April of 2004, city attorney Takenaka told BOC Chair E. Williams that HACLA employee Dushyant Rajan had approached him seeking whistleblower protection in connection with complaints about Loyce. In late March or early April 2004, BOC Chair E. Williams met with BOC member Maria Del Angel (Del Angel) on at least five different occasions and discussed Loyce, Williams, and the investigations. During one such conversation, Del Angel told E. Williams that Loyce brought on Williams as a consultant, but that Williams was not doing what he was paid to do; that Loyce was intimidating RMC officers; and that Del Angel felt Loyce was abusing her authority.

E. Williams decided to terminate Loyce's employment; Loyce was terminated on April 29, 2004. Loyce was terminated "because newly-appointed HACLA officials determined that she had engaged in misappropriation of public funds in connection with a longstanding business associate of hers, Dwayne Williams, who had been a consultant of the HACLA."

By letter dated April 30, 2004, Chief Deputy City Attorney Terree A. Bowers encouraged Assistant U.S. Attorney Lawrence Middleton to "further investigat[e]" complaints the City Attorney had received about Loyce. For example, an "upper-mid

level HACLA manager who alleges that Ms. Loyce was attempting to coerce him and his unit of approximately 30 employees to improperly authorize numerous construction change orders amounting to millions of dollars. My office immediately began investigating these allegations and is continuing this investigation." In addition, executive directors of two of the housing projects' RMC's had "presented similar allegations about how Ms. Loyce and a consultant, Dwayne Williams, are allegedly using threats and intimidation to force the resident organizations to accede to their schemes to make money for themselves." Bowers expressed willingness to cooperate with the U.S. Attorney in the matter.

On December 8, 2004, OIG provided HACLA with a draft of an audit report.[3] On December 16, 2004, OIG conducted an exit conference with HACLA management to obtain its response to the draft report. HACLA, through its recently hired executive director Rudolf Montiel, agreed fully with the findings in the draft report. The final version of Audit Report 2005-LA-1805 was issued on January 21, 2005.

The allegations in the current action

HACLA filed this lawsuit on January 16, 2007. The gravamen of the operative FAC is that KPMG's audits of HACLA for the fiscal years ending December 31, 1999 through 2003 were negligently planned and executed, resulting in KPMG's failure to identify and report to HACLA that "millions of dollars of funds . . . were inappropriately managed, misused and/or misappropriated" by HACLA Executive Director Don Smith, Assistant Executive Director Lucille Loyce, and HACLA consultant Dwayne Williams.[4]

---

[3] HACLA disputes that the draft report was substantially similar to the final report because Rudolph Montiel did not recall that the draft report contained a reference to $13 million in noncompetitively awarded contracts. It was on this limited basis that HACLA refused to admit OIG provided it with a draft of the final report. The trial court sustained KPMG's objections to paragraphs 4 and 9 of Monteil's declaration that HACLA relied on for the denial and the absence of the $13 million figure.

[4] HACLA admitted that KPMG performed audits of HACLA for fiscal years ending December 31, 1999 through 2003 and that these audits were negligently planned

In particular, the FAC alleges as its first paragraph: "This lawsuit concerns the misappropriation of millions of dollars in funds from Plaintiff [HACLA] and the Defendant's failure to identify and otherwise advise its client, HACLA, of that direct and material financial malfeasance."

The complaint continues in the introductory allegations (incorporated by reference in all causes of action) by alleging as follows:

"7. Under contracts entered into between KPMG and HACLA, KPMG was to perform its auditing work in accordance with generally accepted auditing principles applicable to state and local government accounting and financial reporting, issued by the Governmental Accounting Standards Board ("GASB") and the generally accepted government auditing standards ("GAGAS"), issued by the United States General Accounting Office, the Comptroller General of the United States. The GAGAS incorporates the American Institute of Certified Public Accountants' ("AICPA") generally accepted standards of field work and reporting for financial statement audits.

"8. The Single Audit Act of 1984 [citation omitted] standardized the requirements for audits of States, local governments, Indian tribal governments and non-profit organizations that receive and use federal financial assistance programs. As a result, the United States Office of Management and Budget ("OMB") issued OMB Circular A-133 . . . to provide guidance to recipients and auditors for implementing and carrying out the Single Audit Act of 1984's strict requirements.

"9. In addition to the financial statements that KPMG was required to prepare, the GAGAS and the OMB Circular A-133, also required KPMG to evaluate and submit supplemental reports on HACLA's internal control over financial reporting and

---

and executed. HACLA "denie[d] KPMG's characterization of failures under the applicable and governing standards," citing the Declaration of Jennifer Ziegler in Support of Opposition by Plaintiff Housing Authority to Motion for Summary Judgment Filed by Defendant KPMG (Ziegler Decl.), Ex. K, which simply lists the documents she reviewed. Fact No. 2 is thus undisputed.

HACLA's compliance with certain provisions of laws, regulations, contracts and grants. The supplemental reports were to be filed with HACLA's management, its Board of Commissioners and HUD.

"10. Ultimately, the GAGAS and the OMB Circular A-133 place the responsibility on the preparer of the annual audits and reports submitted to the overseeing agency to determine whether the state or local government's financial statements fairly present its financial position and results of operations in accordance with generally accepted accounting standards, as well as whether the internal control structure is such that it provides reasonable assurance that the state or local government is managing the Federal awards in compliance with applicable laws and regulations.

"11. During the period of time that KPMG provided its auditing and oversight services to Plaintiff, millions of dollars of funds were misused, mismanaged and/or misappropriated from Plaintiff by Plaintiff's Executive Director, Don Smith, its Assistant Executive Director, Lucille Loyce and by others. . . .

"12. KPMG either failed to identify the numerous and varied instances of financial malfeasance and/or misappropriation or failed to properly report the manifest misconduct and noncompliance . . . as required by the GAGAS and the AICPA standards and the OMB Circular A-133.

In paragraphs 13 through 18, the FAC sets forth the requirements of various sections of the GAGAS and OMB Circular A-133 with which KPMG is alleged to have failed to comply.

The failure to comply with these requirements is the essence of the first cause of action for professional negligence. The failure to comply with these requirements is also the essence of the second cause of action for breach of contract and the third cause of action for breach of the covenant of good faith and fair dealing, which incorporate paragraphs one through eighteen by reference.

In paragraphs 26, 29, 30, and 31 of the second cause of action, HACLA alleges that the contract "required KPMG to perform its auditing work in accordance with

GAGAS, AICPA standards and the OMB Circular A-133," and that KPMG breached the agreement by failing to comply with specific provisions set forth therein.

Similarly, in paragraph 38 of the third cause of action, HACLA alleges that "By failing to diligently and professionally perform its audit functions in compliance with the standards set forth in the relevant GAGAS and OMB Circular A-133 provisions, KPMG failed to satisfactorily discharge its obligations and duties," thereby breaching the implied covenant of good faith and fair dealing.

HACLA alleges it did not discover KPMG's breaches, and could not reasonably have discovered them, before the issuance of the final OIG report on January 21, 2005. Similarly, it contends that it did not know the full extent of its damages before the OIG report was issued. Thus it contends that the filing of its original complaint on January 16, 2007 was within the two-year period of limitations for professional negligence actions set forth in section 339, subdivision 1 and within the four-year period of limitations for actions based on written contracts set forth in section 337, subdivision 1.

HACLA's complaint and responses to discovery concerning its damages

HACLA alleges in the First Amended Complaint that "[d]uring the period of time that KPMG provided its auditing and oversight services to Plaintiff, millions of dollars of funds were misused, mismanaged and/or misappropriated from Plaintiff by Plaintiff's Executive Director, Don Smith, its Assistant Executive Director, Lucille Loyce and by others. As an example, Loyce consistently entered into contracts with initial values of less than $25,000 which obviated the need to obtain approval from the HACLA Board of Commissioners. She then expanded the value of those contracts many fold by unauthorized amendment, effectively awarding substantial six figure contracts to her longstanding business acquaintances without any review or oversight from the HACLA Board."

The FAC further alleges that KPMG failed to advise HACLA as to millions of dollars "that were inappropriately managed, misused and/or misappropriated by Smith, Loyce and others." HACLA alleges that the failure to advise occurred in all of KPMG's

audit reports, "including the last audit report that was issued on July 21, 2004." These "financial malefactions" are alleged to have been occurring during the audit periods up to and including the July 21, 2004 report.

In its discovery responses, HACLA stated its damages included "at least 60% of the value of the improper contracts awarded for vendor services and goods from the RMCs that were controlled and mismanaged by Smith, Loyce and Williams" and that "in May of 2002, the [A]uthority paid more than $425,000 for moving services under contract HA-2000-014, but the actual payment to the contractor for the work was less than $200,000—thus the damages amount on that contract is in excess of $225,000."

HACLA's responses to three requests for admission and related interrogatories

During discovery, on August 14, 2007, KPMG served its first set of requests for admission to Plaintiff HACLA. (KPMG's First RFA's). On September 11, 2007, HACLA served its responses to KPMG's First RFA's and its responses to KPMG's Form Interrogatory 17.1[5] on KPMG.

The three RFA's at issue and HACLA's responses were as follows:

"REQUEST FOR ADMISSION NO. 43:

"Admit that HACLA officials discussed the findings of this audit with HUD officials on or around December 16, 2004.

"RESPONSE TO REQUEST FOR ADMISSION NO. 43:

"Denied.

---

[5] Form Interrogatory 17.1 in Judicial Council Form DISC-001 asks: "Is your response to each request for admission served with these interrogatories an unqualified admission? If not, for each response that is not an unqualified admission: [¶] (a) state the number of the request; [¶] (b) state all facts upon which you base your response; [¶] (c) state the names, ADDRESSES, and telephone numbers of all PERSONS who have knowledge of the facts; and [¶] (d) identify all DOCUMENTS and other tangible things that support your response and state the name, ADDRESSES, and telephone number of the person who has each DOCUMENT or thing."

"**REQUEST FOR ADMISSION NO. 44**:[6]

"Admit that HUD provided HACLA with a draft of this audit report on or around December 18, 2004.

"**RESPONSE TO REQUEST FOR ADMISSION NO. 44:**

"Admitted in part and denied in part.

"REQUEST FOR ADMISSION NO. 45:

"Admit that the draft audit report issued on December 18, 2004 was substantially similar to the final Audit Report issued on January 21, 2005.

"RESPONSE TO REQUEST FOR ADMISSION NO. 45:

"Denied."

In its Responses to KPMG's Form Interrogatory 17.1, which required an explanation of each response that was not an unqualified admission, HACLA stated the following:

"**Response 43**:

"[¶] . . . [¶] (b) HUD did not discuss the findings of the audit on or around that date. Generally speaking, HUD met and discussed general issues some of which were related to the possibility of certain audit findings and other issues involving the general administration of HACLA.

"**Response 44:**

"[¶] . . . [¶] HUD did not provide a draft of the audit report. What HUD did is provide[] general discussion points about HACLA's management. An 'early version' of the ultimate audit report was not provided at that time. The investigation was not complete and there was discussion about possible findings.

"**Response 45:**

"[¶] . . . [¶] The alleged 'draft audit report' was not substantially similar to the final report. At that early meeting OIG provided general information about its

---

[6] As noted above, the December 18th date was erroneous; the report itself bears the date December 8, 2004.

investigation and largely discussed what potential penalties might be imposed on HACLA if certain findings were ultimately made. The initial report and initial meeting did not discuss the ultimate findings set forth in the January 21, 2005, audit report. In fact, HACLA did not receive the audit report nor learn of the findings until the day the report was issued. OIG contacted HACLA the day before the report was posted on the internet and advised HACLA to look for the report the following day."

After meeting and conferring regarding the responses, HACLA served amended responses to KPMG's Requests for Admission, including this amended response to RFA No. 44: "OIG did not provide HACLA with a draft of the audit report that was ultimately produced by OIG on January 21, 2005. Instead, OIG provided a draft of different information which the parties discussed. Generally speaking, OIG presented information in the conditional form. In other words, OIG discussed that if particular determinations were made, what then might be the appropriate penalty or recommendation or particular course of action."

By early 2008, KPMG had evidence that HACLA's responses to the three disputed requests for admissions were not correct. Although HACLA denied RFA No. 43, which sought HACLA's admission that its officials had "discussed the findings of this audit with HUD officials on or around December 16, 2004," the current HACLA executive director stated in his declaration: "In December 2004, I received draft information from the OIG which I understand is being called a draft report. Following receipt of the draft report, I met with HUD-OIG personnel to discuss the key issues raised."

Although HACLA asserted in response to RFA No. 44 that "HUD did not discuss the findings of the audit in or around [December 18, 2004]," OIG Regional Inspector General Joan Hobbs submitted a declaration in which she confirmed that the meeting had taken place in December and corrected a mistake contained in the final report as to the date the draft report was provided to HACLA. She testified that the draft report was provided to HACLA on December 8, 2004, before OIG met with HACLA officials. In

addition, Hobbs testified: "[O]n December 16, 2004, OIG had detailed and specific discussions of the findings of the 2005 Audit Report, and the facts upon which those findings are based, with HACLA representative at an exit conference conducted at HACLA offices."

Although HACLA denied in its response to RFA No. 45 that the draft report OIG provided in December 2004 was substantially similar to the final report released in January 2005, the evidence was to the contrary. Joan Hobbs stated in her declaration that the draft report "did not differ from the final 2005 Audit Report in any material respect." In addition, Mr. Montiel's letter to OIG, sent before the final report was issued, contained language that could only have come from a draft report. The only material difference between the draft and final reports that HACLA has relied upon is the purported absence of any mention in the draft report of HACLA's noncompetitive award of $13 million in contracts. However, HACLA did not produce any evidence to prove that the $13 million was not mentioned. It simply provided a declaration by Mr. Montiel that stated that he did not recall the $13 million figure being mentioned.[7]

The motion for summary judgment

On March 4, 2008, the trial court heard KPMG's motion for summary judgment based upon the statute of limitations and lack of causation of damages.

The trial court granted the motion for summary judgment on March 12, 2008. The court found the gravamen of all causes of action was professional negligence and that the two-year statute of limitations applied to all causes of action. HACLA was on inquiry notice of its claims against KPMG more than two years before it filed suit on January 16, 2007.[8] On December 16, 2004, OIG discussed its findings with HACLA in specific

---

[7] The trial court sustained KPMG's evidentiary objections to every one of these paragraphs when it granted summary judgment to KPMG.

[8] In reaching this conclusion, the trial court relied, in part, on the OIG draft report dated December 8, 2004, which appears to have been served for the first time in support of KPMG's summary judgment motion on February 5, 2008, together with the Notice to

detail. Even before December 2004, HACLA had sufficient knowledge to put it on notice: "in April 2004, HACLA fired its Assistant Executive Director, Lucille Loyce, based on the very conduct HACLA contends KPMG failed to detect and report" and "by May, 2004, HACLA had sufficient suspicion that it had been injured to cause its Board of Commissioners to approve a resolution to hire forensic accountants to learn 'how much

---

Plaintiff Pursuant to California Rule of Court 2.551(b)(3)(A)(i)–(iii) [regarding the lodging of an unredacted supplemental declaration of Andrew J. Fleming]; KPMG's Amended Separate Statement of Undisputed Material Facts in Support of Motion for Summary Judgment; the Supplemental Declaration of Joan S. Hobbs and exhibits; the redacted Supplemental Declaration of Andrew J. Fleming in Support of Motion for Summary Judgment by Defendant KPMG LLP and exhibits; the Supplemental Declaration of Andrew J. Fleming in Support of Motion for Summary Judgment by Defendant KPMG LLP [Conditionally Filed Under Seal—Subject to Confidentiality Agreement]; and Proof of Service. As none of these documents bear filed stamps, and there is no case docket in the Appellant's Appendix, it is unclear whether the documents were filed. Plaintiff HACLA's Objection to KPMG's Late Filed Evidence states these documents were filed, however, that document also lacks a filed stamp. The trial court signed the Order Overruling Housing Authority of the City of Los Angeles' Objection to KPMG's Late Filed Evidence lodged by KPMG on March 12, 2008. The Order stated: "The Objection is OVERRULED. *San Diego Watercrafts, Inc. v. Wells Fargo Bank, N.A.*, 102 Cal.App.4th 308 (2002) does not apply to the Supplemental Declarations of Joan S. Hobbs and Andrew J. Fleming[.]" The court amended the Order as follows: "and plaintiff has failed to specify any prejudice suffered by receiving evidence of which it was already aware and before its opposition brief was due. Plaintiff also failed to request additional time to file its opposition brief." The trial court's ruling was erroneous. Code of Civil Procedure, section 437c, subdivision (a), provides in pertinent part: "Notice of the [summary judgment] motion *and supporting papers* shall be served on all other parties to the action at least 75 days before the time appointed for hearing." (Code Civ. Proc. 437c, subd. (a), italics added; see also *McMahon v. Superior* Court (2003) 106 Cal.App.4th 112, 115 ["in light of the express statutory language, trial courts do not have authority to shorten the minimum notice period for summary judgment hearings"].) Accordingly, we have not considered any of the late filed evidence to which HACLA objected.

We also note that the court's Order Granting KPMG's Motion for Summary Judgment, filed on March 12, 2008, appears to contain a typographical error at page 2, line 23, where it states "HUD OIG received a draft of that report . . . ." Later in the same paragraph, the court refers [correctly] to *HACLA's* receipt of the report.

of the funding we are obligated to repay' as a result of an audit into 'our relationship with RMC's and how the money flowed.'" Furthermore, "[f]rom May of 2000 through the end of 2002, HUD OIG's investigation of HACLA and a class-action lawsuit against HACLA provided HACLA with detailed allegations regarding Loyce's and Williams's schemes and HACLA's deficient bidding process." Indeed, "[a]s early as the mid-1990's, HACLA knew of allegations of Loyce and Williams's misconduct."

The court further found, for purposes of the motion, that "HACLA incurred injury and its causes of action accrued outside of the two year statute of limitations period." In particular, HACLA alleged in the FAC that its damages included "millions of dollars of funds" that "were misused, mismanaged and/or misappropriated by Smith, Loyce, and others." In its discovery responses, HACLA stated its damages included "at least 60% of the value of the improper contracts awarded for vendor services and goods from the RMCs that were controlled and mismanaged by Smith, Loyce and Williams" and that "in May of 2002, the [A]uthority paid more than $425,000 for moving services under contract HA-2000-014, but the actual payment to the contractor for the work was less than $200,000—thus the damages amount on that contract is in excess of $225,000."

The trial court also determined as a matter of law that HACLA could not prove that KPMG caused its damages because there was no triable issue of material fact regarding HACLA's awareness at all relevant times of the very facts it contended KPMG failed to detect and report.

Judgment for KPMG was filed on March 20, 2008.

Order requiring payment of expenses of proof due to failure to make admissions

On April 9, 2008, KPMG served its motion for costs of proof under Code of Civil Procedure section 2033.420 (Costs of Proof Motion) and supporting documentation, seeking $165,724.65 "as the reasonable expenses [it] incurred in proving matters HACLA denied in response to requests for admission." HACLA served its opposition to the Costs of Proof Motion on April 14, 2008. KPMG served its reply papers on May 5, 2008.

On May 13, 2008, the court granted the Costs of Proof Motion for the full amount requested. In making the order, the court found that HACLA had not objected to any of the three RFA's, that the RFA's sought admissions that were of substantial importance, that HACLA did not have reasonable grounds to believe it would prevail on the matters requested in the RFA's, and there was no other good reason for HACLA's failure to admit the RFA's.

An amended judgment under section 437c was filed on June 16, 2008. It specified KPMG's recovery included "expenses of proof pursuant to Code of Civil Procedure section 2033.420 amounting to $165,724.65.

This timely appeal followed.

DISCUSSION

We review the trial court's order granting summary judgment to KPMG de novo. (*Wiener v. Southcoast Childcare Centers, Inc.* (2004) 32 Cal.4th 1138, 1142 ["we independently examine the record in order to determine whether triable issues of fact exist to reinstate the action"]; *International Engine Parts, Inc. v. Feddersen &Co.* (1995) 9 Cal.4th 606, 611 (*Feddersen*) ["Because the relevant facts are not in dispute, the application of the statute of limitations may be decided as a question of law."]) We review the trial court's order requiring payment of expenses of proof under Code of Civil Procedure, section 2033.420 for abuse of discretion. (*Wimberly v. Derby Cycle Corp.* (1997) 56 Cal.App.4th 618, 637, fn. 10.)

The first issue to be decided is what statute of limitations applies to HACLA's claims. HACLA claims that the four-year period of limitations applicable to written contracts set forth in section 337, subdivision 1 applies to its claims for breach of contract and breach of the implied covenant of good faith and fair dealing, whereas KPMG contends that the two-year period applicable to professional negligence set forth in section 339, subdivision 1 applies. To resolve this issue, the court must determine whether the gravamen of HACLA these claims is professional negligence or breach of

contract. We conclude that the gravamen of all HACLA's claims is professional negligence to which the two-year period of limitations applies.

The second issue to be decided is whether the original complaint was filed within the two-year period of limitations. This, in turn, requires a determination of when HACLA knew or should have known that it had a claim against KPMG. We conclude that HACLA knew and should have known of the claim more than two years before it filed its original complaint.

The second issue also requires a determination as to when HACLA first suffered injury as a result of the actions of KPMG. We conclude that it suffered injury more than two years before it filed its original complaint. Because HACLA knew and should have known of the claim and suffered injury as a result of the actions of KPMG more than two years before filing the original complaint, we conclude that HACLA's claims against KPMG are barred by the two-year period of limitations set forth in section 339, subdivision 1.

The third issue we are asked to decide concerns the trial court's alternate ground for its summary judgment. That was that KPMG was entitled to summary judgment because HACLA could not prove causation of damages because it was undisputed that HACLA was aware of the facts that KPMG allegedly failed to report. In light of our decision that the claim is time-barred, we do not reach this issue.

The fourth issue we are asked to decide is whether the trial court abused its discretion in ordering HACLA to reimburse KPMG's expenses of proving facts HACLA denied in response to three requests for admission. We find no abuse of discretion.

Finally, we are asked to decide if the trial court abused its discretion in the amount it awarded as reimbursement of KPMG's expenses of proving facts HACLA denied. Again, we find no abuse of discretion.

Thus, we affirm the judgment.

1. Section 339, subdivision 1 is the applicable statute of limitations.

HACLA contends that the four-year period of limitations for an action on a written contract set forth in section 337[9] applies to its second and third causes of action for breach of contract and breach of the covenant of good faith and fair dealing. Relying on *L. B. Laboratories, Inc. v. Mitchell* (1952) 39 Cal.2d 56, 63 (*L. B. Laboratories*), HACLA argues that the gravamen of these claims is breach of contract because the claims arise from the failure of KPMG to perform a "positive, specific duty which [the accountant] assumed" under a contract. HACLA alleges the "positive, specific duty" which KPMG assumed arose from its "commitment" in the engagement letter to "(1) inform management about any material errors and any fraud or illegal acts; and (2) inform the audit committee about fraud or illegal acts involving senior management."

KPMG maintains the two-year statute in section 339[10] for professional negligence applies to all of HACLA's causes of action because they are all premised on KPMG's alleged failure to comply with governing professional standards. We agree with KPMG.

As we have stated previously, "the applicable statute of limitations is determined by—as variously phrased—the nature of the right sued upon, the primary interest affected by the defendant's wrongful conduct, or the gravamen of the action." (*Hydro-Mill Co., Inc. v. Haywart, Tilton and Rolapp Ins. Associates, Inc.* (2004) 115 Cal.App.4th 1145, 1158–1159.)

The California Supreme Court explained in *L. B. Laboratories, supra,* 39 Cal.2d 56, that "'the obligation upon which a cause of action is founded may be either contractual or delictual in nature. This distinction is still of fundamental importance with

---

[9] Section 337, subdivision 1 provides in relevant part: "Within four years. 1. An action upon any contract . . . founded upon an instrument in writing . . . ."

[10] "Within two years: 1. An action upon a contract, obligation or liability not founded upon an instrument of writing, except as provided in Section 2725 of the Commercial Code or subdivision 2 of Section 337 of this code . . . ." (§ 339, subd. 1.)

respect to such matters as . . . the limitation of actions . . . . [¶] For the designation of actions as contractual or delictual, it is to be noted that a contract is defined as an agreement to do or not to do a certain thing, and a tort as any wrong, not consisting in mere breach of contract, for which the law undertakes to give the injured party some appropriate remedy against the wrongdoer. If a cause of action arises from a breach of a promise, the action is contractual in nature; if it arises from the breach of a duty growing out of the contract, it is delictual . . . .'" (*Id*. at p. 62.) The court observed that "'actions based on negligent failure to perform contractual duties, such as those owing from a hospital or physician to a patient, from an employer to an employee, and from a landlord to a tenant, although containing elements of both contract and tort, are regarded as delictual actions, since negligence is considered the gravamen of the action.'" (*Id*. at p. 63.)

Actions whose gravamen is accounting malpractice are subject to the two-year statute of limitations set forth in section 339, subdivision 1. (*Sahadi v. Scheaffer* (2007) 155 Cal.App.4th 704, 714; *Curtis v. Kellogg & Andelson* (1999) 73 Cal.App.4th 492, 499.) Even when plaintiff states other claims against accounting professionals, "for which a different statute of limitations might otherwise apply," the two-year statute applies where the gravamen of the action is accounting negligence. (*Sahadi v. Scheaffer*, *supra*, 155 Cal.App.4th at p. 715; *Curtis v. Kellogg & Andelson*, *supra*, 73 Cal.App.4th at p. 503.)

For purposes of determining the appropriate statute of limitations, courts look beyond the labels attached to causes of action to determine if their gravamen is professional negligence or contract. In *Curtis v. Kellogg & Andelson*, *supra*, 73 Cal.App.4th 492, an accounting firm advised a doctor's professional corporation as to how much employee compensation it could pay to the doctor's wife. The compensation was paid and reflected in the corporation's tax return. An audit followed, the IRS issued a notice of deficiency and the corporation sued the accounting firm for professional malpractice, breach of fiduciary duty, fraud and breach of contract. The court discussed

the issue of when plaintiff should have known it had a malpractice cause of action for purposes of the two-year period of limitations contained in section 339, subdivision 1, finding that the malpractice claim was time-barred. The court then turned to the contract and other causes of action. It affirmed the dismissal of all of the causes of action pursuant to section 339, subdivision 1 even though the accounting firm had a contractual relationship with the corporation. It did so because it found that the "gravamen of the breach of contract and breach of fiduciary duty claims are the purported malpractice," to which the two-year period of limitations applied. (*Id*. at p. 503.)

In *Sahadi v. Scheaffer*, accountants had advised their clients about deductions to take in their tax returns, had prepared the returns and had represented the clients in an IRS audit. The clients sued, alleging professional negligence, breach of contract, breach of the implied covenant of good faith and fair dealing, breach of fiduciary duty, fraud and unjust enrichment. The trial court entered judgment for the accountants on the statute of limitations. On appeal, the court analyzed the issues as to all causes of action under section 339, subdivision 1, thus seeming to accept that the gravamen of all the causes of action was professional negligence, even though the accountants were performing pursuant to a contract that plaintiffs claimed they had breached. (*Sahadi v. Scheaffer*, *supra*, 155 Cal.App.4th at pp. 714–723.) The court reversed the trial court's decision on unrelated grounds.

In *Ventura County Nat. Bank v. Macker* (1996) 49 Cal.App.4th 1528, a bank sued an accountant for negligent misrepresentation in an audit report, claiming that the bank had been misled into lending money based on the overstated valuation contained in the audit report. The bank argued that the three-year period of limitations applicable to fraud should apply because negligent misrepresentation is akin to fraud. The court disagreed. It determined that, even though the claim purported to be for negligent misrepresentation, its gravamen was for professional negligence, to which the two-year period of limitations in section 339, subdivision 1 applied. (*Id*. at p. 1531)

Applying these rules to this case, we conclude that the gravamen of the claim was for professional negligence—a delictual claim in the parlance of *L. B. Laboratories*. The essence of HACLA's breach of contract claim is that KPMG failed to comply with the standards of care with which accountants performing the tasks at issue here must comply. The allegations of duty and breach in the breach of contract count consist of the following, along with the similar introductory allegations and averments of the professional negligence claim, which are incorporated by reference in the breach of contract count: KPMG failed "to perform its auditing duties in accordance with GAGAS, AICPA standards and the OMB Circular A-133." It failed to fulfill its duty "to identify and advise of instances of illegal acts, fraud, improprieties, questionable accounting practices, misuse of funds, misappropriation of funds and essentially any accounting or auditing issues that potentially impacted the financial operation of HACLA." It breached its duty "by failing to identify and advise Plaintiff about the direct and material illegal acts . . . " of the wrongdoers. The allegations in the cause of action for breach of the covenant of good faith and fair dealing are based upon the same allegations of duty and breach.

In the words of *L. B. Laboratories*, these are wrongs "'for which the law undertakes to give the injured party some appropriate remedy against the wrongdoer.'" (*L. B. Laboratories*, *supra*, 39 Cal.2d at p. 62.) The remedy, of course, is an action against a professional for failure to comply with the applicable standard of care. As in *L. B. Laboratories*, they arise "from the breach of a duty growing out of the contract [and are therefore] delictual." (*Ibid*.) They are akin to "actions based on negligent failure to perform contractual duties, such as those owing from a hospital or a physician to a patient, from an employer to an employee, and from a landlord to a tenant," which, "although containing elements of both contract and tort, are regarded as delictual actions, since negligence is considered the gravamen of the action." (*Id*. at p. 63.)

Here, as in *Curtis*, the fact that there was a contractual relationship between the accountant and its client did not transform the gravamen of a professional negligence action into a breach of contract.

HACLA argues that *L. B. Laboratories* supports a contrary result. Indeed, the result in that case was to apply the three-year contract statute of limitations to the client's action against the accountant. There, the court relied on the fact that the accountant had "contracted to do a specific thing, namely, to prepare and file plaintiff's income tax returns in the time required by law. There is no equivocation or shading of the obligation. It was not limited to the exercise of ordinary care. It was a positive, specific duty which he assumed." (*L. B. Laboratories*, *supra*, 39 Cal.2d at p. 63.) The accountant failed to review plaintiff's records or file the returns on time. As a result, plaintiff had to pay penalties on the taxes due. (*Id*. at p. 58.) Unlike the situation in which an accountant is employed generally to audit a client's books and "assumes the general obligation to exercise due care," the accountant had agreed to do a specific thing, and the longer contract statute of limitations thus applied. (*Id*. at p. 63.)

HACLA's argument depends on identifying a "positive, specific duty" that KPMG assumed in the contract. As noted above, the engagement letter does create a commitment by KPMG to comply with professional standards. HACLA does not contend that the commitment to comply with professional standards is the "positive, specific duty" on which its argument rests. Such an argument could not succeed. If it did, every person entering into a contract for professional services could insulate himself from the two-year professional negligence statute of limitations solely through the artificial device of spelling out the applicable standard of care in the contract. This would be ineffective because, whether the standard of care is referenced in the contract or not, the gravamen of a claim for failure to comply with professional standards remains professional negligence and cannot be converted into breach of contract by the device merely of referencing the standard of care in the contract. Indeed, the court in *L. B. Laboratories*, *supra*, 39 Cal.2d 56 stated that the assumption of an accountant of the

general obligation to exercise due care in conducting an audit is not the sort of "positive, specific duty" which suggests that the gravamen of the claim is for breach of contract rather than professional negligence. (*Id*. at p. 63.)

HACLA's effort to identify a positive, specific duty rests on statements in the engagement letter about disclosure by KPMG of "material errors and any fraud or illegal acts," including those acts involving senior management. Alternatively, HACLA argues that "KPMG's commitment at least creates a triable issue of fact as to whether the parties intended KPMG to assume a positive, specific duty beyond those it assumed under [the government auditing and accounting standards]."

HACLA's argument is defeated by the very language of the engagement letter. The engagement letter unequivocally establishes that KPMG is not undertaking to uncover fraud or illegal activity and is not even undertaking to investigate matters that are not rendered apparent through the device of HACLA's internal control mechanisms.

In particular, the engagement letter provides that, the nature of the audit is limited to obtaining "reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Absolute assurance is not attainable because of the nature of audit evidence and the characteristics of fraud. Therefore, there is a risk that material errors, fraud (including fraud that may be an illegal act) and other illegal acts may exist and not be detected by an audit performed in accordance with generally accepted auditing standards. . . .

"*To the extent that they may come to our attention*, we will inform management about any material errors and any instances of fraud or illegal acts. Further, *to the extent that they come to our attention*, we will inform the audit committee about fraud and illegal acts that involve senior management, fraud that in our judgment causes a material misstatement of the financial statements of HACLA, and illegal acts, unless clearly inconsequential, that have not otherwise been communicated to the audit committee.

"In planning and performing our audit, we will consider HACLA's internal control in order to determine our auditing procedures for the purpose of expressing an opinion on

the financial statements; not to provide assurance on HACLA's internal control. . . . The limited purpose of this consideration may not meet the needs of some users who require additional information about internal control. We can provide other services to provide you with additional information on internal control which we would be happy to discuss with you at your convenience." (Italics added.)

Similarly, with respect to OMB Circular A-133 in particular, KPMG disavowed any obligation to audit HACLA's internal controls, apart from what the circular and professional standards required, notably because "[t]he tests of internal control performed in accordance with OMB Circular A-133 are less in scope than would be necessary to render an opinion on internal control."

The engagement letter did not create a "positive, specific duty" to uncover fraud and illegality. To the contrary, the unequivocal use of the foregoing language in the engagement letter, undisputed by any admissible evidence, removes any doubt: KPMG did not undertake a "positive, specific duty" beyond its professional accounting and auditing duties. Indeed, it disclaimed such a duty.

Unlike the accountant in *L. B. Laboratories*, KPMG committed to perform audits according to professional standards and did not agree to "do a specific thing." There is no dispute here of a contractual nature. Despite HACLA's designation of its second cause of action as one for breach of contract and its third cause of action as a breach of the covenant of good faith and fair dealing within the contract, the gravamen of the claims is professional negligence and the statute of limitations for professional negligence, section 339, subdivision 1, applies here to all HACLA's causes of action. (*Sahadi v. Scheaffer*, *supra*, 155 Cal.App.4th at p. 715; *Apple Valley Unified School Dist. v. Vavrinek, Trine, Day & Co.* (2002) 98 Cal.App.4th 934, 942 ["As the parties recognize, the statute of limitations for malpractice by an accountant is two years."].)

2. The statutory period began to run upon discovery and actual injury, in this case, more than two years before the filing of the complaint, barring HACLA's claims.

The two-year statute of limitations under section 339, subdivision 1 does not begin to run until a two-pronged test is satisfied. The period commences "when (1) the aggrieved party discovers the negligent conduct causing the loss or damage and (2) the aggrieved party has suffered actual injury as a result of the negligent conduct." (*Apple Valley Unified School Dist. v. Vavrinek, Trine, Day & Co., supra,* 98 Cal.App.4th at p. 942.)

As to the first prong—discovery—the test is not limited to actual discovery: "the statute of limitations begins to run when the plaintiff suspects or should suspect that her injury was caused by wrongdoing, that someone has done something wrong to her. . . . . A plaintiff need not be aware of specific 'facts' necessary to establish the claim . . . . So long as a suspicion exists, it is clear that the plaintiff must go find the facts; she cannot wait for the facts to find her." (*Jolly v. Eli Lilly & Co.* (1988) 44 Cal.3d 1103, 1110–1111, fn. omitted.)

The second prong—actual injury—requires more than the "mere breach of a professional duty, causing only nominal damages, speculative harm, or the threat of future harm—not yet realized . . . ." (*Budd v. Nixen* (1971) 6 Cal.3d 195, 200, superseded by statute on other grounds as stated in *Laird v. Blacker* (1991) 229 Cal.App.3d 159.) There must be actual injury.

However, the statutory period begins to run regardless of whether the full extent of injury is known and regardless of whether the full amount of injury has been suffered. Well over 30 years ago, the California Supreme Court made it clear that knowledge of the full extent of one's damages is not required: "the infliction of appreciable and actual harm, however uncertain in amount, will commence the statutory period." (*Davies v. Krasna* (1975) 14 Cal.3d 502, 514, fn. omitted ["neither uncertainty as to the amount of damages nor difficulty in proving damages tolls the period of limitations"].) It is also

well established that the statutory period begins to run as soon as the plaintiff has suffered "appreciable and actual harm," and that it is not tolled because the harm may be continuing to occur. (See *Van Dyke v. Dunker & Aced* (1996) 46 Cal.App.4th 446, 452 ["the client may suffer 'appreciable and actual harm' before he or she sustains all, or even the greater part, of the damages occasioned by the professional negligence"].)

a. The discovery prong

HACLA disputes both the discovery and actual injury prongs. It maintains it should not be charged with discovery of KPMG's malpractice until after it received OIG's final audit report on January 21, 2005.

HACLA has alleged that KPMG's malpractice or negligence consisted of KPMG's "fail[ure] to identify the numerous and varied instances of financial malfeasance and/or misappropriation or fail[ure] to properly report the manifest misconduct and noncompliance either in the financial statements or supplemental reports to HACLA's Board of Commissioners and HUD . . . ." Although HACLA argues it had no notice until the final OIG report was issued on January 21, 2005, the undisputed facts establish that it knew of the manifold failings of the HACLA's procurement process, at the very latest, in early December 2004, when it received OIG's draft report (with whose findings HACLA expressed agreement at the time).

In fact, the record is replete with undisputed facts demonstrating HACLA's actual notice of the numerous allegations of Loyce's and Williams's misconduct. Dating back to the 1990's, there were lawsuits, letters, complaints, and media reports that put HACLA on inquiry notice, if not actual notice, that there were serious problems involving Loyce and Williams.

Assuming it was KPMG's duty to inform HACLA in the audit reports of the misconduct of Loyce, Williams and others, HACLA was on notice that KPMG had not done so many years before filing its complaint. To the extent HACLA believed it was KPMG's obligation to discover and report such malfeasance, it had actual notice of a potential cause of action against its auditor many years before the OIG audit report.

To cite just two examples, HACLA was notified of the scope of OIG's review of complaints about Loyce and Williams in 2001, and the Board of Commissioners approved a resolution in May 2004 to hire a forensic accountant to find out the specific amount the two had misappropriated.

The undisputed facts demonstrate HACLA had discovered its cause of action more than two years before it filed suit.

b. The actual injury prong

HACLA's claim is that KPMG's failure to tell HACLA in its audit reports about misappropriation and other wrongdoing, mostly concerning the activities of Loyce and Williams, caused HACLA financial injuries. It is true that the financial injury suffered by HACLA included its obligation to repay HUD for HUD funds that were squandered by Loyce and Williams. This amount would have been set forth in the final OIG audit report of January 21, 2005. However, repayment to HUD was only the last in a series of injuries caused by Loyce and Williams. The authorities make it clear that the last injury is not dispositive in this type of case as to when the period of limitations begins to run.

The undisputed evidence establishes that HACLA suffered substantial actual injuries years before the final audit report. HACLA's own FAC establishes that actual injuries were incurred more than two years prior to the January 21, 2007 filing of the complaint. The complaint alleges that "[d]uring the period of time that KPMG provided its auditing and oversight services to Plaintiff, millions of dollars of funds were misused, mismanaged and/or misappropriated from Plaintiff . . . ." In the complaint, Loyce is alleged to have entered into fraudulent contracts during her tenure. KPMG is alleged to have failed to include in its last audit report, dated July 21, 2004, the "financial malefactions" that predated the report.

On their face, these allegations admit that the "financial malefactions" of Loyce and Williams occurred before KPMG's last audit report, dated July 21, 2004, more than two years before the filing of the complaint. Indeed, Loyce was terminated April 29, 2004 and her activities must have occurred by that time, also more than two years before

the complaint was filed. These "financial malefactions" resulted in actual injury to HACLA before the last audit report of July 21, 2004, as monies admittedly were misappropriated from HACLA's coffers as a result of the malefactions.

In addition, HACLA acknowledged in its responses to KPMG's interrogatories that its injuries due to Loyce's and Williams's wrongdoing dated back to 2002 and included overpayment on a moving contract, "thus the damage amount on that contract is in excess of $225,000." The OIG's report, based on field work in 2001 and 2002, established mismanagement of funds during those years, a full five years before HACLA filed this action. (*Van Dyke v. Dunker and Aced*, *supra*, 46 Cal.App.4th at p. 457 [finding actual injury in clients' action against accountants for erroneous tax advice occurred when the malpractice caused them to donate property, lose appreciable expected tax benefits, and pay unanticipated taxes].)

HACLA argues that it did not suffer actual injury before the release of the final OIG audit report based on reasoning contained in *Feddersen*, *supra*, 9 Cal.4th 606. We first note that *Feddersen* is inapposite because the Supreme Court limited its application to cases involving professional negligence by accountants in the preparation of income tax returns. (E.g., *id*. at p. 608 [review granted "to resolve a narrow . . . issue" concerning "an accountant's negligent filing of tax returns"]; *Adams v. Paul* (1995) 11 Cal.4th 583, 588 [*Feddersen* involved "very narrowly drawn circumstances" and "did not articulate a 'rule for all seasons'"]; *Jordache Enterprises, Inc. v. Brobeck Phleger & Harrison* (1998) 18 Cal.4th 739, 763["*Feddersen* presented specialized circumstances and did not articulate a rule of broad or general applicability"]; *Sahadi v. Scheaffer*, *supra*, 155 Cal.App.4th 704, 728 [*Feddersen* majority "chose for policy reasons to establish a bright-line test that actual injury *in law* occurs for purposes of the statute of limitations [in malpractice actions based on professional negligence in preparation of tax returns] only at the conclusion of the audit process"]; *Apple Valley Unified School District v. Vavrninek, Trine, Day & Co.*, *supra*, 98 Cal.App.4th 934, 945 [*Feddersen* did not say that there could never be actual injury in fact until the IRS assessed a deficiency];

Curtis v. Kellogg & Andelson, supra, 73 Cal.App.4th at p. 500, fn. 7 ["[o]bviously in some cases injury will be clear before the notice of deficiency is given to the taxpayer" as it was found to be in *Curtis*].)

Moreover, the precise argument advanced by HACLA has been thoroughly discredited in *Apple Valley Unified School District v. Vavrinek, Trine, Day & Co*, *supra*, 98 Cal.App.4th 934, on which we rely to reject the argument.

Accordingly, HACLA suffered actual injury more than two years prior to filing suit. Because it did, and because it knew and should have known of its claims before that time, its claims are barred by the two-year period of limitations contained in section 339, subdivision 1.

3. The Trial Court Did Not Err In Ordering HACLA to Pay KPMG Its Costs of Proving Facts HACLA Unreasonably Failed to Admit and Did Not Abuse Its Discretion in Imposing Costs in the Amount Requested.

HACLA contends the trial court abused its discretion in ordering it to pay $165,724.65 in fees and costs for failing to "admit the truth of three requests for admission." HACLA maintains it reasonably believed that each RFA concerned a triable issue of fact and that even if it is found to have unreasonably denied the RFA's, KPMG incurred only $46,071.45 in costs to prove the relevant facts. We disagree.

Code of Civil Procedure, section 2033.420, subdivision (a) provides: "If a party fails to admit . . . the truth of any matter when requested to do so under this chapter, and if the party requesting that admission thereafter proves . . . the truth of that matter, the party requesting the admission may move the court for an order requiring the party to whom the request was directed to pay the reasonable expenses incurred in making that proof, including reasonable attorney's fees." (Code Civ. Proc., § 2033.420, subd. (a).) The statute further provides that the court shall make the order unless it finds: " . . . (3) The party failing to make the admission had reasonable ground to believe that the party would prevail on the matter." (Code Civ. Proc., § 2033.420, subd. (b).)

"Awarding costs of proof is improper if the party who denied the request for admission 'held a reasonably entertained good faith belief [it] would prevail on the issue at trial.'" (*Miller v. American Greetings Corp.* (2008) 161 Cal.App.4th 1055, 1066, quoting *Brooks v. American Broadcasting Co.* (1986) 179 Cal.App.3d 500, 511.) Here, KPMG's RFA's asked HACLA to admit that it received a draft of the OIG audit report, that it met with OIG to discuss the draft report, and that the draft was substantially similar to the final version. HACLA denied all three requests.

The truth of the first and second requests was never at issue. HACLA's current executive director, Rudolph Montiel, now concedes that he received the draft report in December 2004 and discussed it with OIG.

As to the third request for admission, the only issue was whether the amount of $13 million in noncompetitively awarded contracts appeared in the draft report. There can be no dispute that it did. Hobbs' testimony was that there were no material differences between the draft and final reports.[11] In fact, the draft report itself was produced to the trial court and showed that the $13 million figure appeared therein.

HACLA's only bases for believing it would prevail on its denial of the RFA's were: (1) Montiel's recollection (or lack of recollection) regarding the date of the draft report; and (2) his admittedly fragmentary memory of what was discussed with OIG.

The trial court had adequate grounds for finding that HACLA lacked a reasonable basis for denying the RFA's.

As for the particular amount the trial court awarded, we cannot say the trial court abused its discretion. The ultimate fact KPMG had to prove as a result of HACLA's unreasonable denial of the RFA's was that HACLA knew or should have known of its claims against KPMG more than two years before filing the complaint. Had HACLA admitted that it saw and discussed the draft OIG report in mid-December 2004, the

---

[11] We did not consider the late-filed draft report in our analysis on the motion for summary judgment, but may consider it as a basis for the trial court's exercise of discretion on the subsequent motion for costs of proof.

critical issue as to the timeliness of this action would have been resolved in KPMG's favor. HACLA offers no evidence that any particular expenditure by KPMG was inaccurate or unwarranted under these circumstances. The trial court did not abuse its discretion.

DISPOSITION

The judgment is affirmed. KPMG shall recover its costs of appeal.

NOT TO BE PUBLISHED.

MILLER, J.*

We concur:

ROTHSCHILD, Acting P. J.

CHANEY, J.

---

* Judge of the Los Angeles Superior Court assigned by the Chief Justice pursuant to article VI, section 6 of the California Constitution.